



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

A taxing question

In Oklahoma each year, hundreds of millions of dollars in sales taxes are going uncollected. Nationwide, the number is set at upwards of \$20 billion by the National Conference of State Legislatures.

The reason for the lost revenue is that most online businesses are not currently required to collect and remit the taxes due. Instead, the responsibility falls on the buyers – people using computers or phones to order online. Most consumers are either unaware or choose to ignore state laws requiring taxes be paid on all purchases made outside the state but

used within the state's borders, including online purchases.

The way it has been

A 1992 U.S. Supreme Court ruling held that businesses selling over the internet could only be required to collect sales tax on purchases made by residents of a state in which the business has a physical location.

In Oklahoma, businesses such as Wal-Mart and Target that sell from in-state locations and via the internet are required to collect sales tax on all purchases, while businesses such as

Amazon.com and e-Bay that have no in-state locations are not required to collect the taxes. It's not that the purchases from the remote retailers are tax free; it's just that most of the taxes due from the purchasers are never remitted.

Federal legislation is under consideration to change this, permitting states to collect taxes due from remote sellers. Two bills, the Main Street Fairness Act and the Marketplace Equity Act, would change the responsibility of collection.

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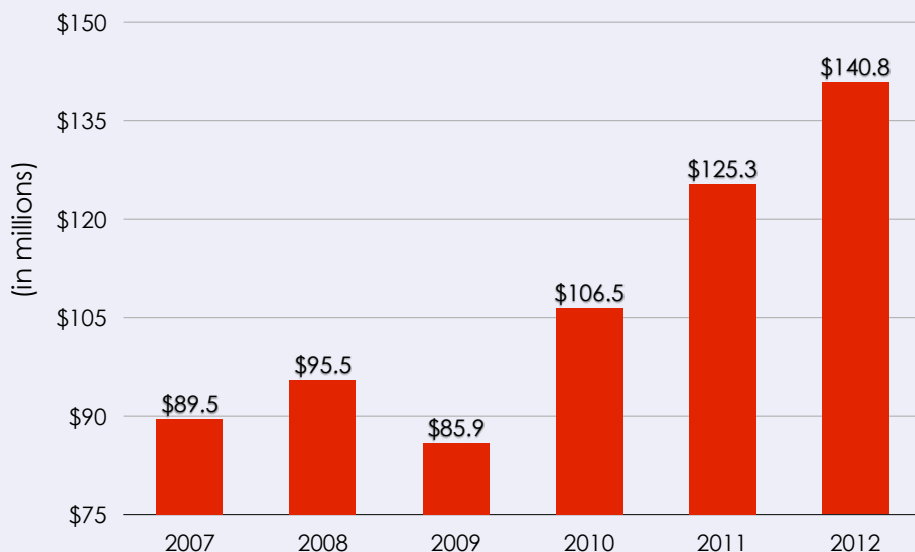
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Oklahoma state and local loss due to non-payment of tax on internet purchases



Source: State and Local Government Sales Tax Revenue Losses from Electronic Commerce, University of Tennessee



Senator's Commentary By U.S. Senator Tom Coburn

Rx: Smart deficit reduction

When the antitax lobbyist Grover G. Norquist made a visit to Capitol Hill recently, leading Democrats welcomed the chance to build up their favorite boogeyman. Harry Reid, the Senate majority leader, said Mr. Norquist has “the entire Republican party in the palm of his hand.” A spokeswoman for Nancy Pelosi, the House minority leader, said Mr. Norquist — who is famous for getting lawmakers to pledge not to support tax hikes or deficit reduction that is paired with revenue increases — was coming to give the G.O.P. its “marching orders.”

But this story is utterly false. Senate Republicans — and many House Republicans — have repeatedly rejected Mr. Norquist’s strict interpretation of his own pledge, a reading that requires them to defend every loophole and spending program hidden in the tax code. While most Republicans do, of course, oppose tax increases,

they are hardly the mindless robots Democrats say they are.

What the narrative does, however, is let Democrats off the hook. If they can make out Republicans as uncompromising ideologues, they can continue refusing to offer detailed plans to reform entitlement programs. That is the real obstacle to a grand bargain on spending, not Mr. Norquist’s pledge.

“What unifies Republicans . . . is tax reform that lowers rates and broadens the tax base . . .”

41 Senate Republicans who had signed his pledge voted for my amendments.

Those 35 Republican pledge-violators are hardly soft on taxes. Rather, they understand that the tax code is riddled with special-interest provisions that are merely spending by another name. If asked to eliminate earmarks for things like Nascar, the tackle-box industry or Eskimo whaling captains — all of which are actual tax “breaks” — most of my

Consider the evidence: I recently proposed amendments to end tax earmarks for movie producers and the ethanol industry. Mr. Norquist charged that those measures would be tax hikes unless paired with dollar-for-dollar rate reductions. And yet all but six of the



colleagues would be embarrassed to demand dollar-for-dollar rate reductions, and rightly so.

As a result, rather than forcing Republicans to bow to him, Mr. Norquist is the one who is increasingly isolated politically. For instance, while his organization, Americans for Tax Reform, was calling my ethanol amendment a tax hike, the Club for Growth, which is far more influential among conservative lawmakers, endorsed my amendment outright.

What’s more, my colleagues have repeatedly rejected Mr. Norquist’s demand that Republicans walk away from any grand bargain on the deficit that includes even a penny of new revenue. Speaker of the House John A. Boehner, who calls Mr. Norquist “some random person,” offered to trade revenue increases for entitlement reform in talks with the White House last summer.

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Coburn

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Republicans on the National Commission on Fiscal Responsibility and Reform made a similar offer, as did Senator Pat Toomey, Republican of Pennsylvania, during last year's deficit supercommittee negotiations. My colleagues, by and large, know that doing nothing to confront our fiscal challenges would mean an automatic tax increase and a cut to entitlement programs.

The problem with the pledge is that it is powerless to prevent future automatic tax increases and has failed to restrain past spending. The "starve the beast"

strategy to shrink the size of the federal government by cutting revenue but not spending was a disaster. Every dollar we borrow is a tax increase on the next generation. And in a debt crisis, higher interest rates and the debasement of our currency would be additional tax hikes. In that sense, no one is doing more to violate the spirit of the pledge than Mr. Norquist himself, who is asking Republicans to reject the very type of agreement that could prevent future tax increases.

What unifies Republicans is not Mr. Norquist's tortured definition of tax purity but the idea of a Reagan- or Kennedy-style tax reform that lowers rates and broadens the tax base by

getting rid of loopholes and deductions.

It's true that Republicans would prefer to lower rates as much as possible, and it's true that Republicans believe smart tax reform will generate more, not less, revenue for the federal government. But Republicans would not walk away from a grand bargain on entitlements and tax reform that would devote a penny of revenue to deficit reduction instead of rate reduction.

The majority of Democrats and Republicans understand the severity of our economic challenges. They know they have to put everything on the table and make hard choices. Legislators who would rather foster political boogymen only delay those critical reforms.

Taxmageddon

The "fiscal cliff" is the anticipated impact of several federal tax changes coupled with mandated spending cuts that culminate on January 1, 2013.

Contributing factors:

1. Tax cuts enacted in 2001 and 2003 are scheduled to expire at the end of this calendar year, resulting in hikes of 36 tax provisions, including the following:

- An increase of all income tax brackets, with the top income tax rate for individuals and small businesses rising from 35 to 39.6 percent and the lowest income tax rate moving from 10 to 15 percent.
- The standard deduction for joint-filing married couples will no longer be equal to that allowed for single counterparts.
- The child care tax credit will be cut in half from \$1,000 to \$500 per child.
- The tax on estates of persons dying on or after January 1, 2013 will be 20 percent higher than those assessed on persons who died before that date and will impact all estates with

assets over \$1 million.

2. The two percent cut in the payroll tax will expire.

3. The impact of a now-expired "patch" that limited the reach of the Alternative Minimum Tax (AMT) will hit 2012 filers, and additional filers will be subject to the AMT as the eligibility cutoff is indexed for inflation in 2013.

4. The remainder of the new or higher taxes implemented under the Affordable Care Act will take effect, including:

- An increase in the Medicare payroll tax from 2.9 percent to 3.8 percent.
- A new 2.3 percent excise tax will be assessed on medical devices retailing for \$100 or more.
- A new, higher threshold for allowing itemized deduction of medical expenses, increasing the current 7.5 percent of adjusted gross income to 10 percent.
- A cap of \$2,500 will be set on tax-free funds that can be contributed

to federal savings accounts used for medical and dependent care expenses; currently, there is no limit on qualified contributions.

5. The first year of the Budget Control Act's ten-year plan to cut \$1.2 trillion in spending takes effect. Half of the cuts are expected to come out of defense funds. Combined with other changes in spending policies, including \$11 billion in reduced Medicare payments for physicians, government expenditures will be reduced by \$103 billion in 2013.

The Congressional Budget Office estimates the total impact of scheduled cuts and revenue-raising provisions will reduce the federal budget deficit by \$607 billion, or 4.0 percent of GDP, between fiscal years 2012 and 2013. Under this scenario, the CBO expects an economic contraction for 2013 that "would probably be judged to be a recession."

Sources: Congressional Budget Office, the Joint Committee on Taxation



Taxes

FROM PAGE 1

As more consumers are choosing to make purchases online instead of in person, more revenue is being lost by local retailers.

“The handwriting is on the wall that states will collect sales taxes on online purchases,” said former Tennessee governor and current U.S. Senator Lamar Alexander, who supports the federal legislation. “This is going to happen – if not this year, then definitely by next year,” he told the Wall Street Journal.

Governors advocate

Pressure is mounting as even some Republican governors are now advocating a change. Among

those joining the call are New Jersey’s Chris Christie, Iowa’s Terry Branstad, Indiana’s Mitch Daniels, Maine’s Paul LePage and Michigan’s Rick Snyder.

Tennessee Governor Bill Haslam joined the chorus last week when he testified on behalf of the National Governors Association before the U.S. House Judiciary Committee. “I am a Republican governor who does not believe in increasing taxes. This discussion isn’t about raising taxes or adding new taxes. This discussion is about states having the flexibility and authority to collect taxes that are already owed by their own in-state residents.”

Those taking an opinion on online sales taxes are, for now, in limited company. Underscoring the sensitivity of the topic of taxes, the majority of lawmakers, including those from Oklahoma, are reserving judgment on the issue.

Local interests weigh in

The Oklahoma Municipal League (OML) is strongly advocating for collection of internet sales by remote retailers. Carolyn Stager, OML executive director, said Oklahoma’s cities and towns depend exclusively on sales taxes for operating expenses.

“It is totally unfair that online companies have a competitive advantage over main street merchants,” Stager said.

“Legislation currently pending in Congress would go a long way in solving these inequities and this ‘tax loophole.’”

An organization of local retailers, the Alliance for Main Street Fairness in Oklahoma, is lobbying state and national lawmakers to support changing the current system. Dale Copeland, owner of Copeland Appliance in Bartlesville, is on the Alliance leadership board.

“Local businesses not only supply great value for merchandise and services, but we also live and volunteer in our community,” Copeland said. “We collect the sales taxes that make it possible to have the parks, streets, clean water and all the local services we need for our families. Out of state businesses do none of these things yet they enjoy an 8.5

percent pricing advantage solely because of outdated regulations.”

Petra Industries, headquartered in Edmond with 294 employees, is the nation’s leading distributor of consumer electronics, custom installation, mobile audio/video and appliance connection supplies. Much of its business is done on behalf of remote retailers.

Petra’s executive vice president, Tish Zitzow, explains that “this is truly a federal issue and to attempt to manage or govern sales tax collections from retailers on a state-to-state basis is not only unconstitutional, in my opinion, but not even realistic.”

Zitzow continues, “The only way to effectively ensure all definitions, translations and enforcements are equal is to have everyone under the same law, which can only be done at the federal level.”

Remote retailers line up

Amazon.com, one of the largest remote retailers, has begun working with states on sales tax collection. As it expands its physical presence, the company is already collecting sales taxes in Kansas, Kentucky, North Dakota, New York Texas and Washington. Within the next few years, it will also collect sales taxes in California, Indiana, Nevada, New Jersey, South Carolina Tennessee and Virginia.

As states and local governments weather through some of the toughest budget straits in history, rather than looking for new or higher taxes, many are looking for a better way to collect revenue that is already due. In today’s polarized political environment, even a little bipartisan support means the discussion is sure to continue.

“This discussion is about states having the flexibility and authority to collect taxes that are already owed by their own in-state residents.”



Oklahoma's rainy day fund gets big boost

The Oklahoma Constitutional Reserve Fund, also known as the rainy day fund, received a more than \$300 million deposit at the start of the new fiscal year in July.

Driven by collections to the General Revenue Fund that far exceeded the official estimate, the balance of the fund now stands at \$556 million.

The \$306.8 million deposit is the largest since the fund was created by voter-approved constitutional amendment in 1985. It is only the second deposit to the fund since the beginning of Fiscal Year 2009.

Allocations to the General Revenue Fund for Fiscal Year 2012 totaled \$5.543 billion, which is 5.9 percent above the official estimate.

The \$596.6 million in the fund at the start of FY-09 was used during the next three years to help offset large reductions in revenue collections due to the Great Recession.

At the beginning of Fiscal Year 2011, the fund balance was \$2.03.

In November 2010, voters approved raising the cap on the fund from 10 percent to 15 percent of the previous fiscal year's certified estimate.

Proponents of the state question argued

the higher cap was needed to provide sufficient funds in the event of a recession similar to the most recent one.

“The \$306.8 million deposit is the largest since the fund was created in 1985.”

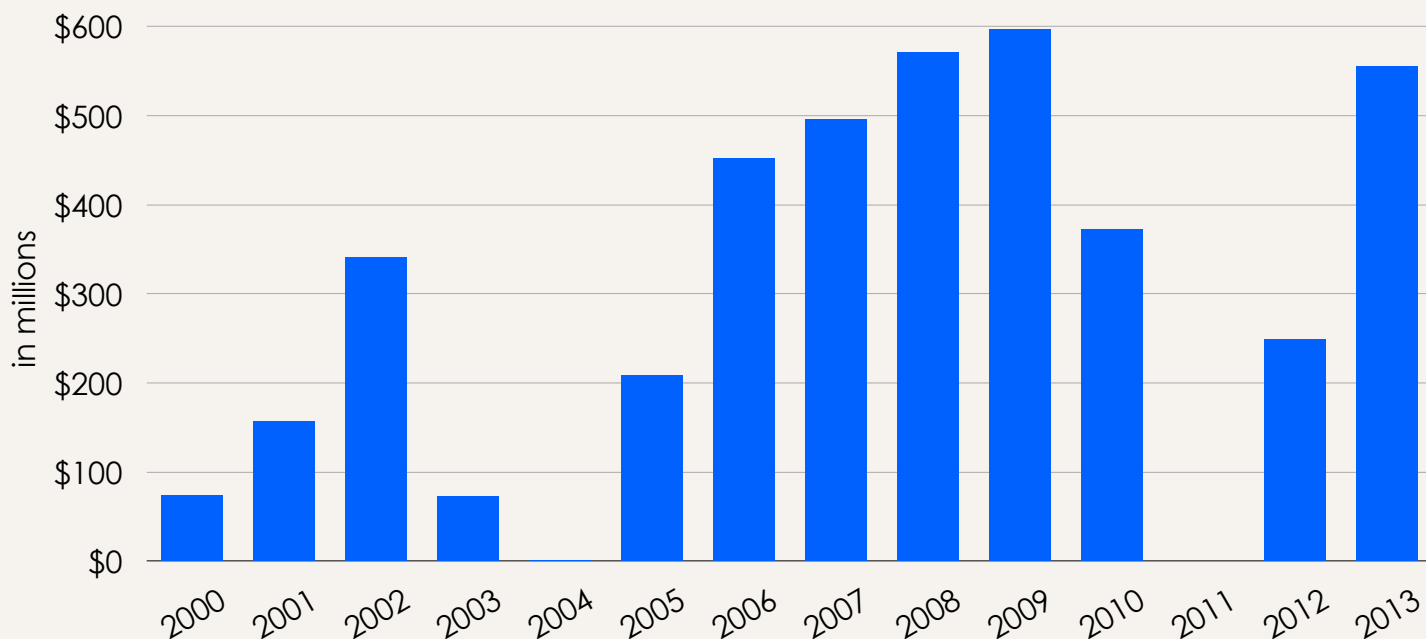
Up to three-eighths of the fund can be appropriated when collections from the current fiscal year drop below appropriated levels.

Another three-eighths can be used when the official estimate for the next fiscal year

are less than the current one.

A maximum of 25 percent of the fund can be used for emergencies, as declared by the governor and approved by the Legislature.

Constitutional Reserve Fund Balance



Source: Office of State Finance



Fiscal Year 2012: Gross receipts vs. General Revenue Fund

Comparison of the Treasurer's July 5 Gross Revenue report and State Finance's July 10 General Revenue Fund (GRF) report illustrates key differences.

Fiscal Year 2012 gross receipts totaled \$10,987.22 billion, while the GRF received \$5,543.1 billion or 50.5% of the total.

In the month of June, the GRF received 56.4% of the gross. Monthly variances of 35% to 58% show the value of using total collections to gauge state economic performance.

From FY-12 gross receipts, the GRF received:

- Personal income tax: 61.8%
- Corporate income tax: 62.6%
- Sales tax: 45.3%
- Gross production-Gas: 71.0%
- Gross production-Oil: 33.2%
- Motor vehicle tax: 32.1%
- Other sources: 44.8%

Fiscal year GRF allocations exceeded the official estimate by \$306.8 million or 5.9 percent. In June, collections fell short of the estimate by \$39.9 million or 6.6 percent

For the year, insurance premium taxes totaled \$194.6 million.

Tribal gaming fees generated \$123.9 million during the year.

Driven by gross production, June revenue collections fall

Oklahoma finished the fiscal year well into the black, but the last month saw the largest decline of the year in gross production tax collections, State

Treasurer Ken Miller announced as he released the gross receipts report for June and fiscal year 2012.

Total collections in June were pushed negative compared to the same month of the prior year due to a 42 percent drop in gross production collections. It was also the seventh consecutive monthly decline in gross production tax collections from the same month of the last year. June

marked only the second month in the fiscal year with total collections dipping below the prior year.

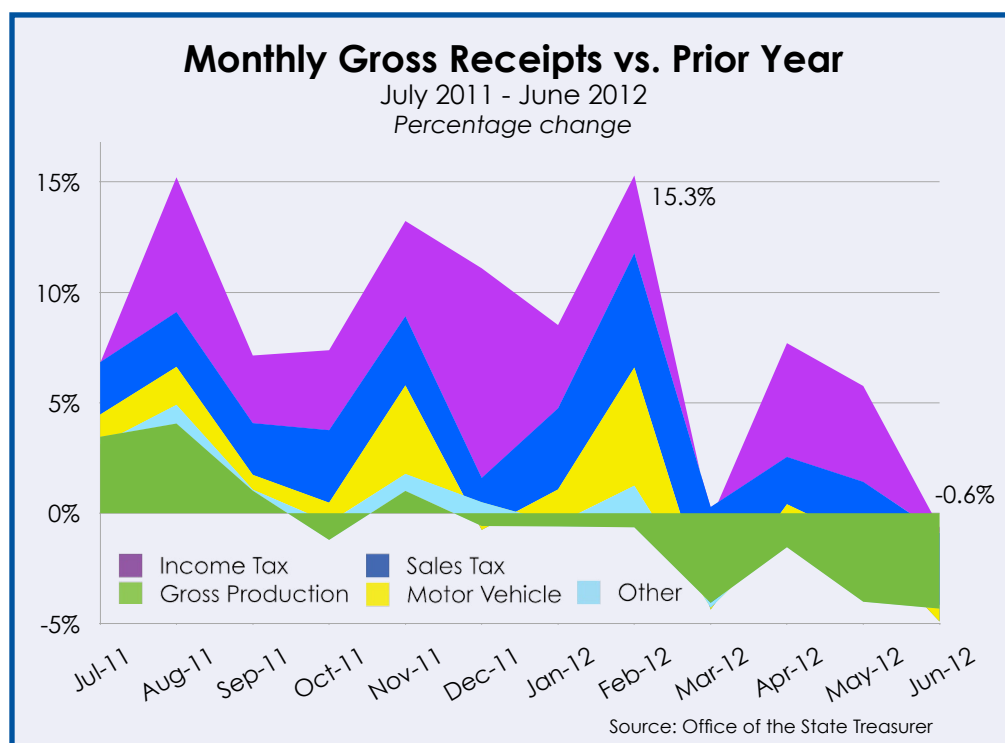
“... there are many reasons to remain optimistic about the state economy.”

“Reductions in gross production and personal income tax collections combine to set our monthly number back, but other economic indicators, such as sales receipts, low unemployment and solid corporate profits, point to

continued expansion,” Miller said.

June collections are down by 0.6 percent from June of last year, Miller said. That

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Revenue

FROM PAGE 6

compares to average growth during FY 2012 of 7.7 percent, including a 10.3 percent increase in income tax collections.

Natural gas prices and timing

The portion of total monthly collections coming from oil and natural gas production has dropped from 10.3 percent of June 2011 receipts to 5.9 percent this past month.

When natural gas prices dropped, many producers switched to oil drilling. At the time, crude prices averaged more than \$100 per barrel (bbl), but prices have dropped the past few months to an average in June of less than \$83/bbl. Those lower oil prices will be reflected in collections in the coming months.

Baker Hughes reports Oklahoma had 201 active rigs as of July 6, of which 149 were for oil and 52 were for natural gas. That is an increase of 28 rigs from the same time last year, when 43 rigs

were drilling for oil and 130 for natural gas.

Working and spending

Sales tax collections in June surged by 12.5 percent from the prior year, showing Oklahomans are generally upbeat about the economy as they increase their purchasing. Growth in personal income tax collections reflect increased employment and are especially noteworthy in light of the quarter percentage point tax cut that took effect in January. Increased corporate income tax collections indicate state businesses are increasing in profitability.

May unemployment, at 4.8 percent, beats the national rate of 8.2 percent by more than three percentage points, and state employment is at a record high with more than 1.7 million Oklahomans holding jobs.

“While the current price environment affecting Oklahoma’s energy industry is less than optimal, there are many reasons to remain optimistic about the state economy,” Miller said.

State unemployment drops again

Even as the state labor force increased, June unemployment dropped to 4.7 percent in Oklahoma, a reduction of 0.1 percentage points from May.

Data from the Oklahoma Employment Security Commission and federal Bureau of Labor Statistics show the state labor force increased by 2,780 during the month with 3,200 jobs being added.

Compared with June 2011, the labor force has increased by 30,190 with new jobs totaling 52,490.

The number of unemployed workers in June is set at 84,980, compared with 107,270 in June of last year.

Oklahoma’s employment report compares to a U.S. unemployment rate of 8.2 percent in June.

During the month, 27 states saw unemployment rate increases, 12 were unchanged and 11 recorded decreases. Nevada had the highest rate at 11.6 percent, while North Dakota was lowest at 2.9 percent.

National economic news briefs

Pension earnings

Calpers reported only a 1% return on its fund investments in the year ended June 30. It is using a 7.5% return assumption in calculating the contribution requirements of state and local governments in California. The 20-year average return for Calpers is still 7.7%. Other pension systems are expected to report similar poor returns for the past year.

Wither the economy

Those economists who think the U.S. is already in a recession cite three consecutive months of declines in retail sales, the drop to 49.7 in the ISM manufacturing index and very weak consumer confidence readings. The majority of economists still forecast growth of around 1.5% for the second quarter and somewhat better growth beyond.

Rising profits

U.S. corporate profits as a percent of GDP are now at 15, versus 12% before the recession and 3% to 6% in the 1980s. Companies have become much more efficient, having reduced costs sharply during the recession. Weaker labor unions have allowed this process to proceed even in the recovery phase of this cycle.

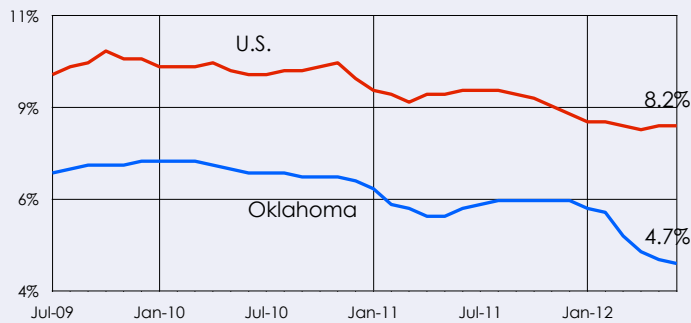
Reprinted from Baird Fixed Income Commentary, July 23, 2012



Economic Indicators

Unemployment Rate

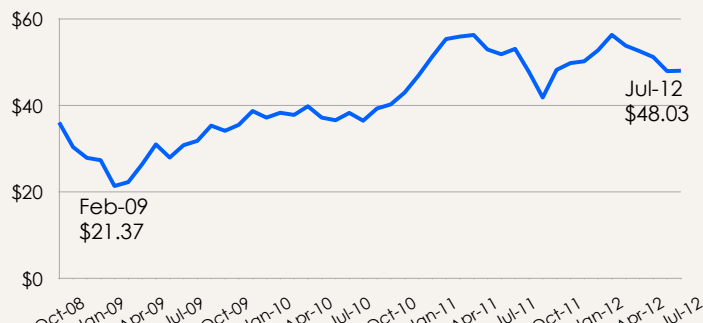
July 2009 – June 2012



Source: Bureau of Labor Statistics

Oklahoma Stock Index

(Top 25 capitalized companies)

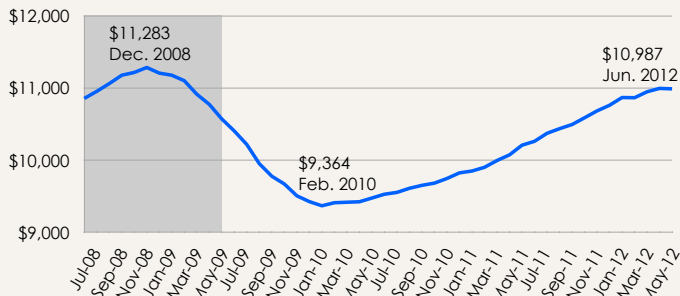


Source: Office of the State Treasurer

Oklahoma 12-Month Gross Receipts

July 2008 – June 2012

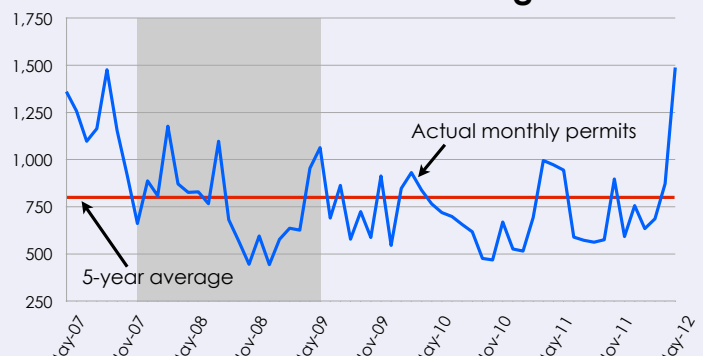
(in millions)



Shaded area denotes U.S. recession

Source: Office of the State Treasurer

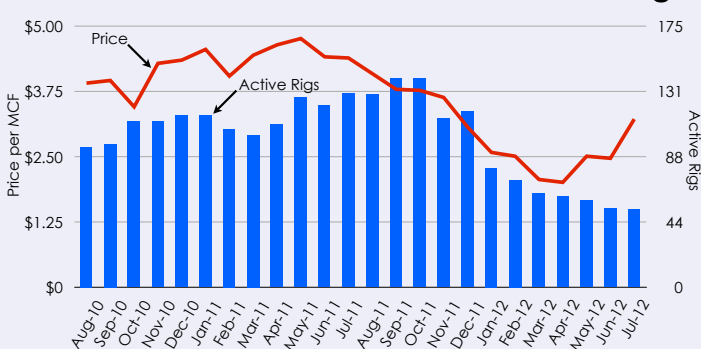
Oklahoma Residential Building Permits



Shaded area denotes U.S. recession

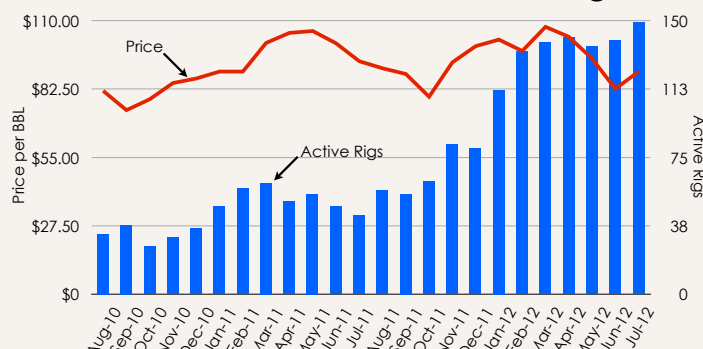
Source: U.S. Census Bureau

Oklahoma Natural Gas Prices & Active Rigs



Source: Baker Hughes & Bloomberg

Oklahoma Oil Prices & Active Rigs



Source: Baker Hughes & Bloomberg